

## Message Text

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ACTION NEA-10

INFO OCT-01 ISO-00 ABF-01 AID-05 CIAE-00 COME-00 EB-08  
FRB-03 INR-07 NSAE-00 TRSE-00 XMB-02 OPIC-03  
SP-02 LAB-04 SIL-01 OMB-01 SS-15 STR-05 CEA-01  
PA-01 PRS-01 DODE-00 NSCE-00 SSO-00 USIE-00  
INRE-00 NEAE-00 /071 W

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O 281823Z OCT 77 ZFF-4  
FM AMEMBASSY TEL AVIV  
TO SECSTATE WASHDC NIACT IMMEDIATE 8965  
AMEMBASSY RIYADH NIACT IMMEDIATE

C O N F I D E N T I A L TEL AVIV 8483

RIYADH FOR SECRETARY BLUMENTHAL

E.O. 11652: GDS  
TAGS: EFIN, IS  
SUBJECT: GOI ANNOUNCES MAJOR CHANGES IN ECONOMIC POLICY

SUMMARY: IN A SURPRISE MOVE, GOI ON OCTOBER 28 ANNOUNCED  
THAT IT WAS FLOATING ISRAELI POUND AND REMOVING MOST RESTRAINTS  
ON FOREIGN EXCHANGE TRANSACTIONS. IN SHORT TERM THIS WILL  
INCREASE RATE OF INFLATION SUBSTANTIALLY (GOI ESTIMATES  
10 PERCENT IN 1977) BUT IT HOPES TO RATIONALIZE RESOURCE  
USESS SO AS TO ENCOURAGE EXPORTS AND INVESTMENT WHILE DIS-  
COURAGING IMPORTS. NEITHER ALL OF THE DETAILS OF  
THE NEW SYSTEM NOR ITS POLITICAL AND ECONOMIC CONSEQUENCES  
ARE YET CLEAR. END SUMMARY.

1. THE GOI ANNOUNCED AFTERNOON OCTOBER 28 FOLLOWING  
ECONOMIC MEASURES:

--ALMOST ALL FOREIGN EXCHANGE CONTROLS ARE ABOLISHED.  
--THE ISRAELI POUND WILL FLOAT ON FOREIGN CURRENCY  
MARKETS, WITH AN INITIAL RATE ESTIMATED AT US \$1.00  
TO IL 15.00

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--THE VALUE ADDED TAX (VAT) WILL GO UP TO 12 PER  
CENT (FROM PRESENT 8PERCENT).  
--FIFTEEN PER CENT TRAVEL TAX WILL BE ABOLISHED, ALTHOUGH  
TRAVEL EXPENDITURE WILL BE SUBJECT TO VAT.  
--PRICES OF SUBSIDIZED GOODS WILL RISE BY 15 PERCENT.  
GOI HAD EARLIER ANNOUNCED THAT AS OF MIDNIGHT OCTOBER  
28, FUEL PRICES, INCLUDING THOSE OF GASOLINE, KEROSENE, AND

HEAVY INDUSTRIAL FUEL ARE HIKED BY AN AVERAGE 25 PER CENT.

2. IN ITS PUBLIC ANNOUNCEMENT THE GOI ESTIMATED THAT THE MEASURES WILL ADD 10 PER CENT TO THE C.O.L. DURING CY 1977. IT ALSO PLEDGED THAT LOWEST INCOME CLASSES AND FAMILIES WITH MANY CHILDREN WILL RECEIVE APPROPRIATE COMPENSATION.

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3. WE HAVE DISCUSSED THE NEW MEASURES WITH MINISTRY OF FINANCE (MOF) ECONOMIC ADVISOR EPHRAIM DOVRAT AND DEPUTY DIRECTOR GENERAL DAN HALPERIN AND RECEIVED THE FOLLOWING INFORMATION WHICH HAS NOT YET BEEN MADE PUBLIC:  
--SOME LIMITED FOREIGN CURRENCY CONTROLS WILL REMAIN. EACH PERSON IS LIMITED TO \$3,000 IN FOREIGN BANKNOTES HOLDING AND FOREIGN CURRENCY ACCOUNTS HELD ABROAD, ALTHOUGH NO LIMIT IS PLACED ON FOREIGN EXCHANGE HOLDINGS IN ISRAELI BANKS. A LIMIT OF \$3,000 IS ALSO SET ON CURRENCY TAKEN ABROAD BY ISRAELI TOURISTS.  
--THE FOREIGN EXCHANGE MARKET WILL BE CONDUCTED VIA ISRAELI COMMERCIAL BANKS. THE BANK OF ISRAEL HAS NO OBLIGATION TO BUY OR SELL FOREIGN EXCHANGE. IF THE GOI DECIDES THAT THE EXCHANGE RATE HAS BECOME TOO UNFAVORABLE AND IS THEREBY DEPRESSING EXPORTS, IT MAY BUY FOREX IN THE MARKET. IF IT DECIDES THAT SPECULATION IS DRIVING  
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THE RATE TOO HIGH IT WILL SELL FOREIGN EXCHANGE. ALTHOUGH THE OFFICIAL EXCHANGE RATE HAS BEEN ABOUT \$1 EQUALS IL 10.36, THE RATE FOR EXPORTS WAS MUCH HIGHER, DEPENDING ON VALUE-ADDED IN EXPORTS. A RATE OF \$1 EQUALS IL 15 WOULD GIVE ONLY A SLIGHT BOOST TO EXPORTS WITH HIGH VALUE ADDED. IMPORTS HOWEVER SHOULD BE DAMPENED BY THE HIGHER RATE. BANKS WILL BE CLOSED ON SUNDAY, USUALLY A WORKING DAY, IN ORDER TO LET THEM PREPARE FOR FOREIGN EXCHANGE OPERATIONS.

--IN PRINCIPLE, NO ADJUSTMENTS (EXCEPT FOR LOW-INCOME FAMILIES) WILL BE MADE IN THE WAGE BILL. GOI WILL TRY TO AVOID MAKING COST OF LIVING ADJUSTMENTS UNTIL NEXT REGULARLY SCHEDULED CHANGE IN APRIL. HOWEVER, MINISTER ERHLICH IS EXPECTED TO MEET SHORTLY WITH HISTRADUT SECRETARY-GENERAL MESHEL TO DISCUSS LATEST MEASURES AND LABOR WILL LIKELY WIN CONCESSIONS ON THESE POINTS.

--PURCHASE TAX ON IMPORTS WILL BE ABOLISHED, AND TARIFF RATES ABOVE 12 PER CENT WILL BE REDUCED BY 20 PER CENT (E.G., 60 PER CENT TARIFF RATE WILL FALL TO 48 PER CENT).

4. WHEN ASKED WHAT MOTIVATED THIS MOVE, DOVRAT AND HALPERIN ATTRIBUTED IT TO MINISTER EHRLICH'S DESIRE TO ELIMINATE THE MULTIPLE EXCHANGE RATE SYSTEM. PERHAPS AS IMPORTANT, IT WAS A WAY TO SILENCE THE CRITICS OF THE LIKUD WHO COMPLAINED THAT THERE HAD BEEN NO CHANGE IN POLICY FROM THE PREVIOUS GOVERNMENT. NO ONE WOULD DENY THAT THIS IS A CHANGE IN POLICY.

5. IN OUR DISCUSSION WITH DOVRAT AND HALPERIN, IT WAS UNCLEAR WHAT WILL BE THE MEASURES' NET EFFECT ON THE GOI BUDGET DEFICIT. SOME EXPENDITURE WILL BE REDUCED; FOR EXAMPLE EXPORT INCENTIVE PAYMENT WILL DROP. GOI EXPENSES WILL ALSO GO UP AS COSTS OF GOVERNMENT PURCHASES OF GOODS AND SERVICES RISE.  
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6. ONLY DISSENTING VOTE IN CABINET DECISION WAS BY DAVID LEVY OF HERUT. SINCE LEVY REPRESENTS LOWER-INCOME HERUTNIKS (HE WAS HERUT'S LEADER IN HISTADRUT), DISSENT COULD POINT TROUBLE WITH THE LIKUD'S SEPHARDIC SUPPORTERS.

7. GOI EXPERTS DO NOT THEMSELVES KNOW ALL THE DETAILS OR IMPLICATIONS OF THIS REVOLUTIONARY CHANGE IN GOI POLICY. WE WILL FURNISH ADDITIONAL POLITICAL AND ECONOMIC ANALYSIS SHORTLY.  
LEWIS

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